

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 04-03**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

Application of Tennessee sales and use tax to Digital Identification Numbers.

**SCOPE**

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- A. The taxpayer must not have misstated or omitted material facts in the transaction;
- B. Facts that develop later must not be materially different from the facts upon which the ruling was based;
- C. The applicable law must not have been changed or amended;
- D. The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- E. The taxpayer directly involved must have acted in good faith in relying upon the ruling, and a revocation of the ruling must inure to the taxpayer's detriment.

## **FACTS**

[THE TAXPAYER] is a provider of digital certificate solutions for businesses and individuals wanting to perform secure electronic commerce and communications over the Internet.

Internet identifications are delivered through [THE TAXPAYER'S] Identification Number (Digital ID) Center, an on-line service that is open 24 hours a day, 7 days a week. A Digital ID, sometimes called a digital certificate, is a file on a computer that identifies the user. Some software applications use this file to prove a person's identity to another person or computer. One common use of Digital IDs is online banking. When an individual accesses their bank account online, the bank must be sure that the individual is the correct person to get account information. A Digital ID confirms an individual's identity to the online bank.

[THE TAXPAYER] sells Digital IDs for use with servers, browsers, e-mail applications and software content. [THE TAXPAYER'S] customers ("End Users") apply for an Internet ID by first accessing [THE TAXPAYER'S] website and then completing an on-line registration form. Once [THE TAXPAYER] authenticates the identity of an applicant (via a third party such as Equifax), the applicant can only receive the Digital ID electronically over the Internet. A Digital ID typically contains the following: (1) End User's public key; (2) End User's name; (3) Expiration date of the public key; (4) Name of the issuer (the certification authority, otherwise known as the "CA", that issued the Digital ID); (5) Serial number of the Digital ID; and (6) Digital signature of the issuer. The Digital ID is not a text file.

As noted above, Digital IDs are used for secure Internet commerce and communications. The Digital ID interaction is between an Internet browser and the End User's servers. In the case of e-mail, the interaction is between two Internet browsers. In both cases, there is no need to check a central database at [THE TAXPAYER].

## **QUESTIONS**

1. Are the Digital IDs subject to Tennessee sales and use tax as computer software?
2. Are the Digital IDs subject to Tennessee sales and use tax as taxable services?

## **RULINGS**

1. No.
2. No.

## ANALYSIS

(1) The sale of customized or packaged computer software, as well as the modification of existing software, is subject to sales and use tax. University Computing Company v. Olsen, 677 S.W.2d 445 (Tenn. 1984); Creasy Systems Consultants, Inc. v. Olsen, 716 S.W.2d 35 (Tenn. 1986). The term “sale” is defined to include “[the] *transfer* of customized or packaged computer software, which is defined to mean, information and directions loaded into a computer which dictate different functions to be performed by the computer whether contained on tapes, discs, cards, or other device or material. For such purpose, computer software shall be considered tangible personal property; however, the fabrication of software by a person for such person's own use or consumption shall not be considered a taxable ‘use’ . . . TENN. CODE ANN. § 67-6-102(27)(B).

Here, the Digital ID provided by the [THE TAXPAYER] does not dictate any function to be performed by the End User’s computer system. Rather, the Digital ID is used to identify third parties who are clients of the End User. Because the Digital ID does not dictate the performance of a particular function, it is not computer software and is not subject to sales and use tax.

(2) The sale of tangible personal property at retail is a taxable privilege. TENN. CODE ANN. § 67-6-201. Further, certain services are taxable. TENN. CODE ANN. §§ 67-6-201, 67-6-205. Taxable services include, but are not limited to, repair work, telecommunication services, installation and certain warranty or services contracts. Also, services provided as part of the sale of tangible personal property are taxable as part of the sales price of such property. TENN. CODE ANN. § 67-6-102(a)(28).

It should be noted, however, that naming or characterizing a sale as a service does not cause the transaction to escape taxation when the transaction is essentially a transfer of tangible personal property. If the tangible personal property is a “crucial element” of the total transaction, the transaction is a sale of tangible personal property. *See Thomas Nelson, Inc. v. Olsen*, 723 S.W.2d 621 (Tenn. 1987), Creasy Sys. Consultants v. Olsen, 716 S.W.2d 35 (Tenn. 1986).

Some transactions are essentially sales of services, and the courts have recognized that although property may be transferred to the customer incidental to the sale of nontaxable items, such incidental property does not transform the sale into a taxable sale of tangible personal property. Commerce Union Bank v. Tidwell, 583 S.W.2d 405 (Tenn. 1976). With respect to such “incidental” tangible personal property, the Tennessee Supreme Court has held “when the primary function and purpose of the taxpayer is to provide services, the ownership, use and maintenance of certain types of personal property and equipment are necessary in order to enable it to furnish the services, so that the taxpayer, not its customer, is the ultimate user or consumer within the meaning of sales and use tax statutes.” Nashville Mobilphone Co. v. Woods, 655 S.W.2d 934, 937 (Tenn. 1983).

Applying the above analysis, [THE TAXPAYER'S] sales of Digital IDs do not constitute transfers of tangible personal property. Similarly, [THE TAXPAYER'S] sales of Digital IDs do not constitute taxable services. Because there is no transfer of tangible personal property and no taxable services in this case, [THE TAXPAYER'S] sales of Digital IDs are not subject to Tennessee sales and use tax.

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Approved: Loren L. Chumley  
Commissioner of Revenue

Date: 1/28/04